No. 11146

In the United States Circuit Court of Appeals for the Ninth Circuit

PACIFIC PUBLIC SERVICE COMPANY, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The Tax Court's findings of fact and opinion (R. 148–164) are reported at 4 T. C. 742.

JURISDICTION

The petition for review (R. 166–175) involves an alleged overpayment of federal income tax for the year 1940 in the amount of $30,488.15. On March 26, 1943, the Commissioner of Internal Revenue mailed to the taxpayer a notice of a deficiency in the amount of $7,343.21 of income taxes for the year 1940. (R. 17–25.) Within ninety days thereafter and on June 17, 1943, the taxpayer filed a petition with the Tax

Court, under the provisions of Sections 272 and 322 of the Internal Revenue Code, for a redetermination of that deficiency, and for a further determination that the taxpayer had overpaid $30,488.15 income taxes for that year, for which claim for refund was alleged to have been filed (R. 1, 5–17). On April 20, 1945, the Tax Court entered its decision determining an overpayment of $117.82 (R. 165). The petition for review of such decision was filed on July 20, 1945 (R. 166–172) pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

In 1940 taxpayer sold shares of stock which it had obtained in 1935 in exchange for an unsecured demand note pursuant to a plan of reorganization of taxpayer's debtor under Section 77B of the Bankruptcy Act. The question is whether the taxpayer's basis for the shares of stock sold in 1940 is the same as the taxpayer's basis for the demand note. The answer to this question depends up whether the demand note was a "security" within the meaning of Section 112 (b) (3) of the Revenue Act of 1934, or within the meaning of Section 112 (1) as added to the Internal Revenue Code by Section 121 (b) of the Revenue Act of 1943, and deemed to be included in the revenue laws applicable to taxable years beginning after December 31, 1931, by Section 121 (e) of the Revenue Act of 1943.

STATUTES INVOLVED

The statutes involved are set out in the Appendix, *infra*.

STATEMENT

The facts as stipulated (R. 43–88, 147), and as found by the Tax Court (R. 149–157) may be summarized as follows:

The taxpayer is a corporation organized under the laws of California. (R. 149.) In 1940 the taxpayer sold in an arm's-length transaction all of its bonds and shares of stock in California Consumer Corporation (hereinafter referred to as the new company) for amounts aggregating $19,654.85. (R. 149.) These bonds and shares of stock had been acquired by the taxpayer in 1935 in exchanges for bonds, preferred stock and an unsecured demand note of California Consumers Company (hereinafter referred to as the old company), pursuant to a plan of reorganization of the old company under Section 77B of the Federal Bankruptcy Act, whereby the new company, organized for that purpose, acquired substantially all the assets of the old company. (R. 151–154.)

The parties who prior to the plan held bonds, stock, and the note of the old company, received pursuant to the plan the following interests in the new company (R. 153):

Holding in old company	*Interest in new company received*
$3,496,500 principal amount of bonds (of which $75,000 principal amount was held by taxpayer).	$3,496,500 principal amount of bonds and 27,872 participating certificates for 27,972 shares of stock.
$15,343 shares no par value preferred stock (of which 902 shares were held by taxpayer).	23,014.5 shares.
$478,270 unsecured demand note (held by taxpayer).	3,278.5 shares.
25,000 shares common stock (held by taxpayer).	Nothing.
Total	$3,496,500 bonds; 54,274 shares.

By reason of its respective holdings of bonds and stock and the note of the old company, taxpayer, as a result of the consummation of the plan, received the following (R. 154):

Holding in old company	*Interest in new company received*
$75,000 principal amount of bonds	$75,000 principal amount of bonds with participating certificates for 600 shares of common stock held by voting trustees.
902 shares preferred stock	1,353 shares of common stock.
$478,270 note-unsecured	3,287.5 shares of common stock.
25,000 shares common stock	Nothing.

The plan also provided for the dismissal, with prejudice to all parties plaintiff, of a dividend suit filed December 29, 1933, in the Superior Court of California against taxpayer, seeking the recovery of the amount of certain dividends alleged to have been illegally declared and paid on both preferred and common stock of the old company, in the sum of approximately $1,000,000. (R. 156.)

Taxpayer has never claimed any portion of the unsecured indebtedness of the old company as partially or wholly worthless in any of its income tax returns, nor has taxpayer received any tax benefit through bad debt deductions with respect thereto. No part of taxpayer's cost of preferred stock and bonds of the old company or of its common stock and bonds of the new company has been claimed or allowed as a deduction or otherwise in any tax return filed by taxpayer prior to 1940. (R. 156–157.)

Taxpayer reported a net loss on its federal income tax returns for 1933, 1934, and 1935, and no tax has been paid by taxpayer for those years. (R. 157.)

In its tax return for 1940 the taxpayer reported losses totalling $92,524.23 on the sale of the bonds and

stock of the new company. In computing these losses, the taxpayer used as a basis for the bonds and stock which were acquired in exchange for the bonds of the old company its basis for the old bonds, and it likewise carried forward its basis for the preferred stock of the old company to the shares of stock of the new company received therefor in the 1935 exchange. As a basis, however, for the 3,287.5 shares of new stock received in exchange for the demand note of $478,270, the taxpayer used a value of $1.90 per share. (R. 149–150, 151–152.)

The Commissioner ruled that none of the exceptions in the Revenue Act of 1934 to the recognition of gain or loss on the 1935 exchange applied and hence that the taxpayer was not entitled to carry forward its old bases to the new bonds and stock. (R. 23.)

In the Tax Court, the taxpayer, in addition to contending (1) that the basis of the old bonds carried over and became the basis for the new bonds and common stock received therefor, and (2) that the basis of the old preferred stock became the basis for the new common stock received therefor, also contended (3) that its basis for the demand note of the old company should carry over to the new shares of common stock received therefor, and further contended (4) that its basis of $6,000 for the common stock of the old company, which was extinguished in the 1935 exchanges, should be included in its basis for the bonds and stock of the new company. (R. 6, 8–14, 40–41.)[1]

[1] Taxpayer also claimed an additional deduction of $873.40 for capital stock tax, but this point was conceded by the Commissioner. (R. 149.)

The Tax Court sustained taxpayer's contentions (1) and (2) above, and rejected contentions (3) and (4). (R. 160–161, 163–164.)

The Commissioner has not appealed from the parts of the decision below adverse to him. The taxpayer urges error only with respect to contention (3) above. (Br. 2, 6–7.)

SUMMARY OF ARGUMENT

1. The term "stock or securities" as used in Section 112 (b) (3) of the Revenue Act of 1934 does not include an unsecured demand note.

The term has appeared in provisions of the revenue laws relating to the recognition of gain or loss on exchanges of property for more than twenty-five years and for the past twelve years the courts have consistently construed the term as not embracing short-term or demand notes. Congress is aware of the construction which the courts have placed upon the term, and the legislative history of other provisions of the revenue laws indicates that Congress intended the term to be thus restricted.

2. The legislative history of Section 112 (1), added to the Internal Revenue Code by Section 121 (b) of the Revenue Act of 1943 and a similar provision made applicable to earlier Revenue Acts, shows that the term "stock or securities" used in that new subsection was intended to have the same restricted meaning that the term has as used elsewhere in Section 112. When Congress has used the term "stock or securities" in a broader sense than that attributed to

it in Section 112, it has specifically defined and broadened the term.

3. Recent decisions of the Supreme Court involving reorganization of insolvent corporations are distinguishable from the present case.

4. Under the Tax Court's holding that the unsecured demand note was not a "security" within the meaning of subsections (b) (3) or (1) of Section 112, it was unnecessary for the Tax Court to pass upon the question whether the basis of the note should in any event be reduced by virtue of the dismissal, pursuant to the plan of reorganization, of the dividend suit against the taxpayer in the state court. The Commissioner contended below and contends here that the dismissal of this suit was part of the consideration passing to the taxpayer for the surrender of the demand note. If this Court should disagree with the holding of the Tax Court that the note was not a "security" within the meaning of the statutory sections here involved, the case should be remanded to the Tax Court for further proceedings.

ARGUMENT

I

Preliminary discussion

The sole question in the present petition for review is with respect to the taxpayer's basis for computing loss on 3,287.5 shares of stock of California Consumers Corporation sold by taxpayer in 1940. These shares were acquired by taxpayer in 1935 in ex-

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change for an unsecured demand note in the amount of $478,270 of California Consumers Company, pursuant to a plan of reorganization of the latter company under Section 77B of the Bankruptcy Act.

The taxpayer's contentions are that the transaction in 1935, whereby it acquired the shares of stock sold in 1940, comes within the provisions of Section 112 (b) (3) of the Revenue Act of 1934 (Appendix, *infra*), or within the provisions of Section 112 (1) as added to the Internal Revenue Code by Section 121 (b) of the Revenue Act of 1943 (Appendix, *infra*), and as deemed to be included in the revenue laws applicable to taxable years beginning after December 31, 1931, by Section 121 (e) of the Revenue Act of 1943, and accordingly that the basis of the shares sold in 1940 shall be the same as the basis of the demand note which was exchanged for these shares.[2]

The Tax Court held that the unsecured demand note unchanged for the shares of the new company was not a "security" within the meaning of either Section 112 (b) (3) or Section 112 (1), and hence that neither section applied. (R. 161–164.)[3] These sections will be discussed below.

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[2] See Sections 111 (a), 113 (b) and (a) (16) of the Internal Revenue Code (Appendix, *infra*); Section 113 (a) (6) of the Revenue Act of 1934 (Appendix, *infra*); and Section 121 (c) (1) and (e) of the Revenue Act of 1943 (Appendix, *infra*).

[3] The Tax Court did not pass upon the Commissioner's ruling that the taxpayer did not receive the bonds and stocks of the new company pursuant to a reorganization within the meaning of Section 112 (g) of the Revenue Act of 1934, as amended. (R. 23, 161, 164.) Section 121 (d) (4) of the Revenue Act of 1943 (Appendix, *infra*) amended Section 112 (g) of the Internal Revenue Code, defining "reorganization" as used in Section 112, so as to

II

The unsecured demand note was not a "security" within the meaning of Section 112 (b) (3)

Section 112 (b) (3) of the Revenue Act of 1934 provides:

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.[4]

The meaning of the term "securities" in provisions of the Revenue Acts relating to the recognition of gain or loss has been frequently litigated. One of the early pronouncements on the question was by the

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make the definition inapplicable to the new Section 112 (b) (10) and the new Section 112 (1). The definition of reorganization in Section 112 (g) is, however, still applicable to Section 112 (b) (3), unqualified by anything in the new Section 112 (b) (10) and (1). The Commissioner contends that there was no reorganization within the meaning of Section 112 (g) and hence that Section 112 (b) (3) will also for that reason not apply to the present case. But since the Commissioner does not contest the Tax Court's holding (R. 164) that there was a plan of reorganization within the meaning of Section 112 (1) and does not contend that the phrase "stock or securities" is used in any different sense in Section 112 (1) than in Section 112 (b) (3), the case may be decided by determining that the unsecured demand note is or is not a "security" within the meaning of Section 112 (1).

[4] Since at least 1918, Revenue Acts have contained the phase "stock or securities" in provisions relating to recognition of gain or loss. Section 202 (b) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, and Revenue Act of 1921, c. 136, 42 Stat. 227; Section 203 (b), Revenue Act of 1924, c. 234, 43 Stat. 253, and Revenue Act of 1926, c. 27, 44 Stat. 9; and Section 112 of subsequent Revenue Acts and the Internal Revenue Code.

Supreme Court in 1933 in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462. There, as one of the grounds of its decision, the Court held that short-term purchase money notes, payable within four months, were not securities within the intendment of the Revenue Act.

The Circuit Courts of Appeals have uniformly followed this decision of the Supreme Court as holding that short-term or demand obligations do not constitute "securities" within the meaning of Section 112 or its antecedents. *L. & E. Stirn, Inc.* v. *Commissioner,* 107 F. 2d 390 (C. C. A. 2d); *Lloyd-Smith* v. *Commissioner,* 116 F. 2d 642 (C. C. A. 2d); *Commissioner* v. *Sisto F. Corp.,* 139 F. 2d 253 (C. C. A. 2d).

Where a taxpayer has argued, as does the taxpayer here (Br. 16–23), that the *Pinellas* case, *supra,* involved notes which were received upon an exchange and that the rule of that case should not be applied to notes given up on an exchange, the courts have pointed out that the phrase "stock or securities" appears twice in Section 112 (b) (3), once to refer to what a party turns in to a corporation being reorganized and then to refer to what the recipient takes from the reorganized company, and have stated that there is no reason for thinking that the phrase has a different meaning in the two instances. *Neville Coke & Chemical Co.* v. *Commissioner,* 148 F. 2d 599 (C. C. A. 3d), certiorari denied, October 8, 1945; *Bedford* v. *Commissioner,* 150 F. 2d 341 (C. C. A. 2d).

It will be noted that all except one of the Circuit Courts of Appeals decisions cited above are subsequent to the decision of the Supreme Court in *LeTulle*

v. *Scofield,* 308 U. S. 415, cited by the taxpayer. (Br. 18.) The denial by the Supreme Court of the petition for certiorari in *Neville Coke & Chemical Co.* v. *Commissioner, supra,* indicates that those two decisions were not deemed to conflict.

The case of *Burnham* v. *Commissioner,* 86 F. 2d 776 (C. C. A. 7th), cited by the taxpayer (Br. 19), involved ten-year notes, only two years of which had expired. The court did not express disagreement with the view that short-term notes are not securities within the meaning of Section 112 (b) or its antecedent Section 203 (b), but rested its decision primarily on the fact that the notes there involved were for a long term.

No case is cited by the taxpayer holding that demand or short-term notes are securities within the meaning of Section 112 (b) or similar provisions of earlier acts. What the taxpayer really seeks is a reexamination of the decision of the Supreme Court in the *Pinellas* case, *supra.* That case was decided more than twelve years ago and the phrase "stock or securities" has been in Section 112 and its counterpart in earlier statutes for more than twenty-five years. Congress, we submit, is well aware of the construction which the courts have placed upon that phrase, and, as will be pointed out hereinafter, would doubtless have amended or defined the phrase if the decisions of the courts had not correctly interpreted the meaning of Congress.

III

The unsecured demand note was not a "security" within the meaning of Section 112 (1)

Section 112 (1) as added to the Internal Revenue Code by Section 121 (b) of the Revenue Act of 1943

(Appendix, *infra*), and as deemed to be included in revenue laws applicable to taxable years beginning after December 31, 1931, provides in part as follows:

> (1) *General Rule.*—No gain or loss shall be recognized upon an exchange consisting of the relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (b) (10), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.[5]

1. The taxpayer argues in effect (Br. 9–13) that there should be read into the above-quoted section, after the words "stock or securities", the words "or other obligations", and that the section thus embraces the claims of all creditors of a corporation which undergoes a reorganization under Section 77B of the Bankruptcy Act.

In support of this contention, the taxpayer stresses (Br. 11) the words "or other obligations" in the report of the Senate Finance Committee which accompanied the Revenue Bill of 1943. The taxpayer has failed to note, however, that that language relates to the Revenue Bill of 1943 as it was *reported to the Senate.* The bill, as it was reported to the Senate, contained in the proposed new Section 112 (1), the words "stock, securities, or other obligations of the corpora-

[5] The Tax Court held (R. 164) that the exchange here involved was made to effectuate a plan of reorganization approved by a court in a proceeding described in subsection (b) (10), and the Commissioner does not contest this holding.

tion whose property is transferred."[6] In the Senate the entire proposed new Section 112 (1) was deleted from H. R. 3687, 78th Cong., 1st Sess., without explanation,[7] and in the bill passed by the Senate on January 21, 1944, no such provision as Section 112 (1) appears.

In the Conference Committee numerous amendments were made to H. R. 3687 as it had passed the Senate, and under the conference amendments a new subsection (1) was added to Section 112 of the Internal Revenue Code as it now appears. It is true that the Conference Committee Report contains the word "creditors" in the sentence quoted by the taxpayer (Br. 12), but this language is followed by the sentence—

> Section 112 (1) provides that no gain or loss shall be recognized upon the exchange of stock or securities of the old corporation solely for stock or securities in the new corporation,

and an illustration is then given involving bondholders.[8]

The legislative history of Section 112 (1), instead of supporting taxpayer's contentions, leads, we believe, to the contrary conclusion, namely, that Congress, by

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[6] See Section 115 (b) of H. R. 3687, 78th Cong., 1st Sess., as reported to the Senate on December 21, 1943, by Mr. George of the Committee on Finance.

[7] This was accomplished by the so-called Johnson amendment. Senator George opposed the Johnson amendment because, among other things, it omitted the provision dealing with gain or loss to the security holder. 90 Cong. Record, Part 1, pp. 190–193.

[8] H. Rep. No. 1079, 78th Cong., 2d Sess., pp. 47–48 (1944 Cum. Bull. 1059).

eliminating the words "or other obligations" intended that the section should not embrace all types of creditors' claims or obligations. Also it cannot be doubted that the committees were cognizant of the Supreme Court case of *Pinellas Ice Co.* v. *Commissioner, supra,* for both the report of the Committee on Finance and the Conference Report refer to court decisions which cite the *Pinellas* case. If the holding of that case that short-term notes are not securities within the intendment of Section 203 (b) (or its successor Section 112 (b)) was not intended to be applied to the new subsection 112 (1), it is difficult to believe that the words "or other obligations," which had been in the bill, would not have been left in the law as finally enacted.

Indeed, it seems clear that Congress intended the phrase "stock or securities" as used in the new subsection (1) of Section 112 to have the same meaning as used elsewhere in Section 112 of the Code, for in Section 1 (c) of the Revenue Act of 1943 (Appendix, *infra*), it is provided that, except as otherwise expressly provided, terms used in that Act shall have the same meaning as when used in the Internal Revenue Code. This is further emphasized by the provision of Section 121 (d) (4) of the Revenue Act of 1943, which specifically excepts the new subsections (b) (10) and (1) of Section 112 from the definition of "reorganization" contained in Section 112 (g) of the Code.

A further indication of the Congressional intent is found in the treatment of the phrase "stock or securities" in another section of the Internal Revenue Code. In Supplement R of the Internal Revenue Code relat-

ing to exchanges and distributions, in obedience to orders of the Securities and Exchange Commission, the phrase "stock or securities" is used. Congress desired, however, that, as used in that supplement, the term should have a broader meaning than the term as used in Section 112, and accordingly in Section 373 (f) of the Internal Revenue Code the term was defined, for purposes of that supplement only, as meaning—

> shares of stock in any corporation, certificates of stock or interest in any corporation, notes, bonds, debentures, and evidences of indebtedness (including any evidence of an interest in or right to subscribe to or purchase any of the foregoing).

However, that supplement also contains in Section 373 (d) (3) a new term, namely, "nonexempt property", which, as used in that supplement, is defined as meaning, among other things—

> Short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding twenty-four months, exclusive of days of grace.

The provision of Section 373 quoted above and the other provisions of Supplement R appeared first in the Revenue Act of 1938, c. 289, 52 Stat. 447. In discussing the definition of "stock or securities" therein contained, the Senate Committee on Finance stated (S. Rep. No. 1567, 75th Cong., 3d Sess., p. 36 (1939–1 Cum. Bull. (Part 2) 779, 805)):

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> In order to facilitate exchanges or distributions in furtherance of the policies of section 11 (b) of the Public Utility Holding Company Act of 1935, the term "stock or securities" is given a broader meaning in section 373 (f) than it possesses in connection with the reorganization provisions of section 112.

We think it clear that if Congress had intended the phrase "stock or securities", as used in new subsection (1) added to Section 112 by the 1943 Act, to have an enlarged meaning or a different meaning from the term as used elsewhere in Section 112, it would have specifically so provided, as it did in Supplement R, with respect to the term as used in that Supplement.

The Tax Court was clearly correct, we submit, in holding that the unsecured demand note which taxpayer exchanged in 1935 for the stock sold in 1940 was not a "security" within the meaning of either Section 112 (b) (3) or Section 112 (1), and accordingly that the basis of the note did not carry over and become the basis of the stock.

2. This conclusion does not conflict with either *Helvering* v. *Limestone Co.,* 315 U. S. 179, or *Helvering* v. *Cement Investors,* 316 U. S. 527. The former case involved a question of basis of the assets in the hands of the new corporation, and the latter involved bondholders and an exchange of property under Section 112 (b) (5) of the Revenue Act of 1936. In those cases the old companies were insolvent, and the Supreme Court based its decisions on the ground that in the insolvency proceedings the stockholders were excluded and the creditors stepped into the shoes

of such stockholders and acquired the equity ownership of the property of the old corporations. Such a theory could not be applied to the present case, as well pointed out by the Tax Court. (R. 158–160.)

3. The decision of the Tax Court in the present case does not conflict with its decision in *Withington* v. *Commissioner,* decided May 30, 1944 (1944 P–H Tax Court Memorandum Decisions, par. 44,183). In that case the Tax Court does state that the taxpayer held Bay State Road notes, but it further states that none of these notes are directly involved therein, as the case is presented. It seems clear from the opinion that the Tax Court was concerned only with the stocks and bonds there involved.

IV

If this court should uphold the taxpayer's contention that the unsecured demand note is a "Security" within the meaning of subsections (b) (3) or (1) of section 112, the case should be remanded to the tax court for further proceedings

In view of its decision that the unsecured demand note was not a "security" within the meaning of either subsection (b) (3) or subsection (1) of Section 112 and accordingly that neither section permitted the carry-over of taxpayer's old basis, it was unnecessary for the Tax Court to pass upon the effect of that provision of the plan of reorganization which provided (R. 156) for the dismissal, with prejudice to all parties plaintiff, of a dividend suit filed in the Superior Court of California, against taxpayer, seeking the recovery of the amount of certain dividends alleged to have been illegally declared and paid on both preferred

and common stock of the old company, in the sum of approximately $1,000,000.

It was the contention of the Commissioner below (R. 104–105, 109–110, 113, 114–115) and it contends here that the dismissal of this suit was part of the consideration accruing to the taxpayer for the surrender of the unsecured demand note of the old company in 1935.

Both subsection (b) (3) and subsection (1) of Section 112 relate to exchanges of stock or securities *solely* for stock or security. It is undeniable that the dismissal of the suit against taxpayer was neither stock nor securities. Cf. *United States* v. *Hendler,* 303 U. S. 564.

Section 113 (a) (6) of the Revenue Act of 1934, as amended (Appendix, *infra*) provides for an adjustment to or allocation of the basis of the property exchanged where the property acquired upon the exchange consists in part of the type of property permitted to be received without the recognition of gain or loss and in part of other property.

Hence, if this Court should uphold the taxpayer's contention that the exchange in 1935 was within the provisions of subsection (b) (3) or (1) of Section 112, there should nevertheless be an adjustment in the basis of the old demand note, and the case should be remanded to the Tax Court for further proceedings to that end.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed. If the decision is reversed, the case should be remanded to the Tax Court for further proceedings.

Respectfully submitted.

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FEBRUARY 1946.

APPENDIX

Internal Revenue Code:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

(26 U. S. C., 1940 ed., Sec. 111.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(16) *Basis established by Revenue Act of 1934.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1936, and the basis thereof, for the purposes of the Revenue Act of 1934 was prescribed by section 113 (a) (6), (7), or (8) of such Act, then for the purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1934.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as herein provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *.

(26 U. S. C. 1940 ed., Sec. 113.)

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(2) *Stock for stock of same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(1) [as added by Section 121 (b) and (e), Revenue Act of 1943] *Exchanges by Security Holders in Connection With Certain Corporate Reorganizations.*—

(1) *General rule.*—No gain or loss shall be recognized upon an exchange consisting of the relinquishment or extinguishment of stock or

securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (b) (10), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

(2) *Exchange occurring in taxable years beginning prior to January 1, 1943.*—If the exchange occurred in a taxable year of the person acquiring such stock or securities beginning prior to January 1, 1943, then, under regulations prescribed by the Commissioner with the approval of the Secretary, gain or loss shall be recognized or not recognized—

(A) to the extent that it was recognized or not recognized in the final determination of the tax of such person for such taxable year, if such tax was finally determined prior to the ninetieth day after the date of the enactment of the Revenue Act of 1943; or

(B) in cases to which subparagraph (A) is not applicable, to the extent that it would be recognized or not recognized under the latest treatment of such exchange by such person prior to December 15, 1943, in connection with his tax liability for such taxable year."

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(6) [as amended by Section 213 (i), Revenue Act of 1939, c. 247, 53 Stat. 862, and by Section 121 (c) (1) and (e), Revenue Act of 1943, *supra*] *Tax-free exchanges generally.*—If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, or section 112 (1), the basis

shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) or section 112 (1) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. Where as part of the consideration to the taxpayer another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for the purposes of this paragraph, be considered as money received by the taxpayer upon the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

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Sec. 112

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is

substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(10) [as added by Section 121 (a) and (e), Revenue Act of 1943 *supra*] *Gain or loss not recognized on reorganization of corporations in certain receivership and bankruptcy proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

(A) in a receivership, foreclosure, or similar proceeding, or

(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

* * * * *

(g) [as amended by Sec. 121 (d) (4) and (e) of the Revenue Act of 1943, *supra*] *Definition of Reorganization.*—As used in this section "(other than subsection (b) (10) and subsection (1)) and in section 113 (other than subsection (a) (22))—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) a transfer by a corporation

of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

Revenue Act of 1943, c. 63, 58 Stat. 26:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) * * *

(b) *Act Amendatory of Internal Revenue Code.*—Except as otherwise expressly provided, wherever in this Act an amendment is expressed in terms of an amendment to a chapter, subchapter, title, supplement, section, subsection, subdivision, paragraph, subparagraph, or clause, the reference shall be considered to be made to a provision of the Internal Revenue Code.

(c) *Meaning of Terms Used.*—Except as otherwise expressly provided, terms used in this Act shall have the same meaning as when used in the Internal Revenue Code.

SEC. 121. REORGANIZATION OF CERTAIN INSOLVENT CORPORATIONS.

(a) *Nonrecognition of Gain or Loss on Certain Reorganizations.*—Section 112 (b) (relating to recognition of gain or loss upon certain

exchanges) is amended by inserting at the end thereof the following:

"(10) *Gain or loss not recognized on reorganization of corporations in certain receivership and bankruptcy proceedings.*—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77m of the National Bankruptcy Act, as amended) is transferred, in a taxable year of such corporation beginning after December 31, 1933, in pursuance of an order of the court having jurisdiction of such corporation—

"(A) in a receivership, forclosure, or similar proceeding, or

"(B) in a proceeding under section 77B or Chapter X of the National Bankruptcy Act, as amended,

to another corporation or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation."

(b) *Recognition of Gain or Loss of Security Holders in Connection With Certain Corporate Reorganizations.*—Section 112 (relating to recognition of gain or loss) is amended by inserting at the end thereof the following:

"(1) *Exchanges by security holders in connection with certain corporate reorganizations.*—

"(1) *General rule.*—No gain or loss shall be recognized upon an exchange consisting of the relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (b) (10), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

"(2) *Exchange occurring in taxable years beginning prior to January 1, 1943.*—If the exchange occurred in a taxable year of the per-

son acquiring such stock or securities beginning prior to January 1, 1943, then, under regulations prescribed by the Commissioner with the approval of the Secretary, gain or loss shall be recognized or not recognized—

"(A) to the extent that it was recognized or not recognized in the final determination of the tax of such person for such taxable year, if such tax was finally determined prior to the ninetieth day after the date of the enactment of the Revenue Act of 1943; or

"(B) in cases to which subparagraph (A) is not applicable, to the extent that it would be recognized or not recognized under the latest treatment of such exchange by such person prior to December 15, 1943, in connection with his tax liability for such taxable year."

(c) *Basis.*—Section 113 (a) (relating to basis of property) is amended—

(1) by inserting after "112 (b) to (e), inclusive," in paragraph (6) the following: "or section 112 (1),";

(2) by inserting after "property permitted by section 112 (b)" in paragraph (6) the following: "or section 112 (1)"; and

(3) by inserting after paragraph (21) the following: * * *

(d) *Technical Amendments.*—

(1) Section 112 (c) (relating to gain from exchanges not solely in kind) is amended by inserting after "(b) (I), (2), (3), or (5)", the following: ", or within the provisions of subsection (1),", and by inserting after "paragraph" the following: "or by subsection (1)".

(2) Section 112 (d) (relating to gain of corporation) is amended by inserting after "subsection (b) (4)" the following: "or (10)".

(3) Section 112 (e) (relating to loss from exchanges not solely in kind) is amended by inserting after "subsection (b) (I) to (5), inclusive," the following: "or (10), or within the provisions of subsection (1),".

(4) So much of section 112 (g) (defining "reorganization") as precedes paragraph (I) is amended to read as follows:

"(g) *Definition of Reorganization.*—As used in this section (other than subsection (b) (10) and subsection (1)) and in section 113 (other than subsection (a) (22))—".

(5) Section 112 (k) (relating to assumption of liability) is amended by striking out "subsection (b) (4) or (5)" wherever appearing therein and inserting in lieu thereof the following: "subsection (b) (4), (5), or (10)".

(6) Section 718 (a) (6) (A) is amended by striking out "112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5)" and inserting in lieu thereof "112 (b) (3), (4), (5), or (10), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), (5), or (10)".

(e) *Effective Date.*—Provisions having the effect of the amendments made by subsection (a), subsection (c) (3), and subsection (d) (2), (3), (4), (5), and (6), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1933, but shall not affect any tax liability for any taxable year beginning prior to January 1, 1943. Provisions having the effect of the amendments made by subsection (b), subsection (c) (I) and (2), and subsection (d) (I), shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1931.

(26 U. S. C. 1940 ed., Supp. IV, Sec. 112, 113.)

U. S. GOVERNMENT PRINTING OFFICE: 1946